The Economic Outlook and the President's Agenda
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Remarks as Prepared

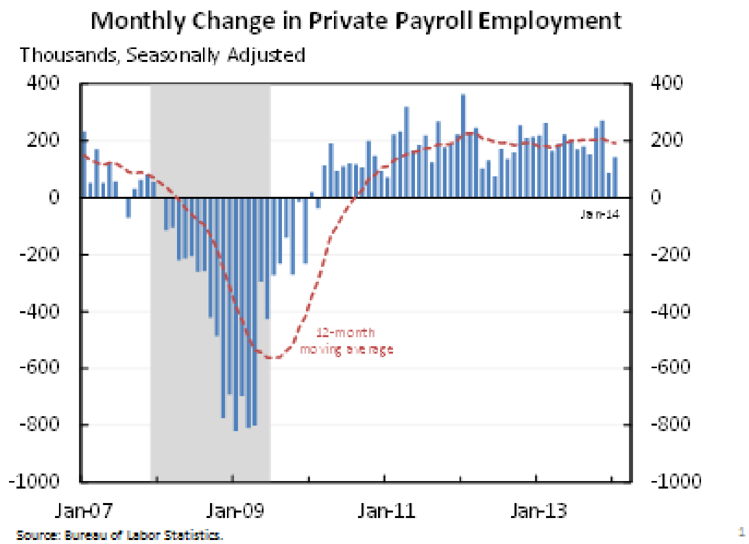
In my remarks today I want to start by saying a few words about the current state of the economy, the opportunities we have and then discuss the President's plans to continue to strengthen the recovery in the near-term while raising the economy's productivity and output over the medium- and long-run and ensuring that those gains are broadly shared.

The Economy Five Years after the Crisis

The U.S. economy now stands more than five years removed from one of the most tumultuous and challenging periods in its history. While it's now become something of a platitude, I am obligated to point out that around this time in 2009, the shock that had just hit the economy looked, in some respects, to be as bad as or even possibly worse than the initial shock that touched off the Great Depression. As my predecessor Christina Romer has pointed out, the plunge in stock prices in late 2008 was quite similar to what occurred in late 1929, but was compounded by sharper home price declines, ultimately leading to a drop in household wealth that was substantially greater than the loss in wealth at the outset of the Great Depression. Alan Greenspan, Barry Eichengreen and other economists have all pointed out important respects in which the shocks that led to this crisis were worse than the shocks that precipitated the Great Depression.

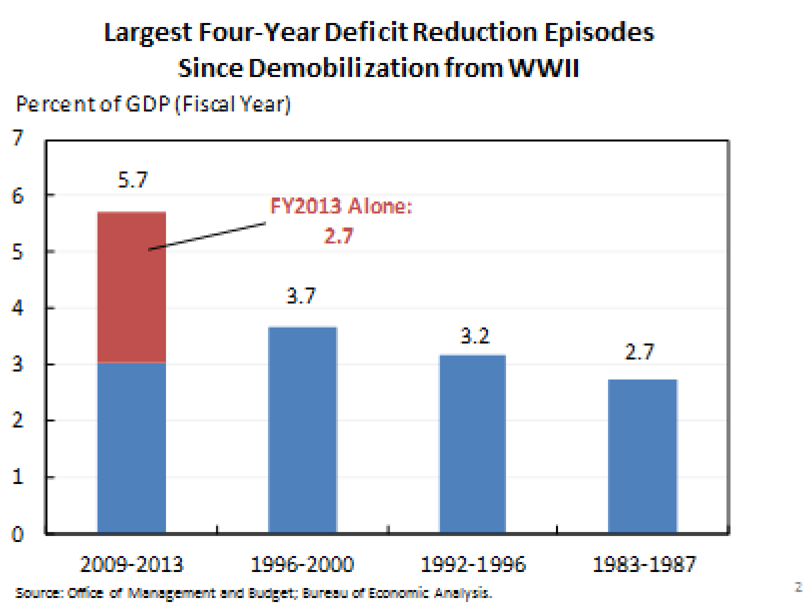
While we are still digging out of that large hole, there's no question a great deal of progress has been made. Private employers added 2.4 million jobs in 2013, marking the third consecutive year that private employment increased by more than two million. From its trough in February 2010 through January 2014, private employment has risen in 47 consecutive months for a total of 8.5 million jobs added (Figure 1). A lot is made each month of the ups and downs in the employment data, but looking over a longer period, we have seen steady, consistent job growth, despite a number of additional headwinds that have emerged in the last few years. And the month-to-month volatility in the jobs numbers is in line with what it was prior to the recession.

Figure 1: Businesses Have Added 8.5 Million Jobs Over the Last 47 Months



The progress seen last year was notable in part because the steep decline in the Federal budget deficit was a major headwind on macroeconomic performance. Figure 2 shows the largest four-year reductions in the Federal budget deficit since the demobilization from World War II. Since the end of fiscal year 2009, the deficit has fallen by 5.7 percentage points of GDP, with nearly half of that reduction—2.7 percentage points of GDP—coming in FY 2013 alone.

Figure 2: The Decline in the Deficit Since FY2009 Represents the Largest Four-Year Improvement Since the Demobilization from WWII



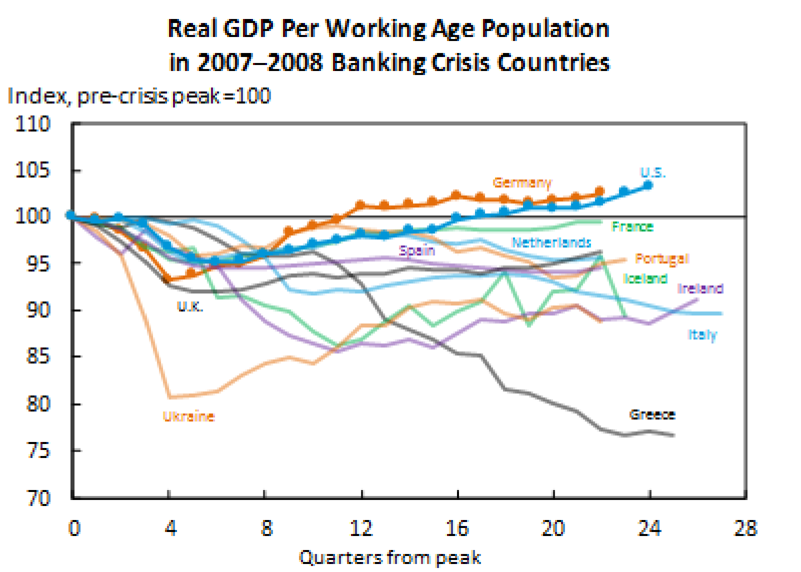
Some of the deficit reduction in 2013 was a natural consequence of the gradual improvement in the economy, and a large portion of it was due to policy decisions, like the spending caps agreed to in the Budget Control Act of 2011 and the end of the temporary payroll tax holiday. The fiscal contraction would, of course, have been much worse were it not for the permanent extension of tax cuts for middle-income households.

While these factors reflected a balanced approach to making progress toward fiscal sustainability, they were unnecessarily compounded with the onset of budget sequestration in March, and with the government shutdown in October that took a large bite out of fourth-quarter GDP growth. I will return to say a bit more about fiscal policy in a moment, but certainly, the fiscal environment should be much less of a headwind over the next several years.

Before I move on to the more forward-looking part of my talk, I would like to make one last point about the economy's progress to date. By now there is a general understanding that recoveries from financial crises tend to be slower than recoveries from recessions caused by other types of shocks because heavy household debt burdens and tight credit conditions can linger for an extended period of time.

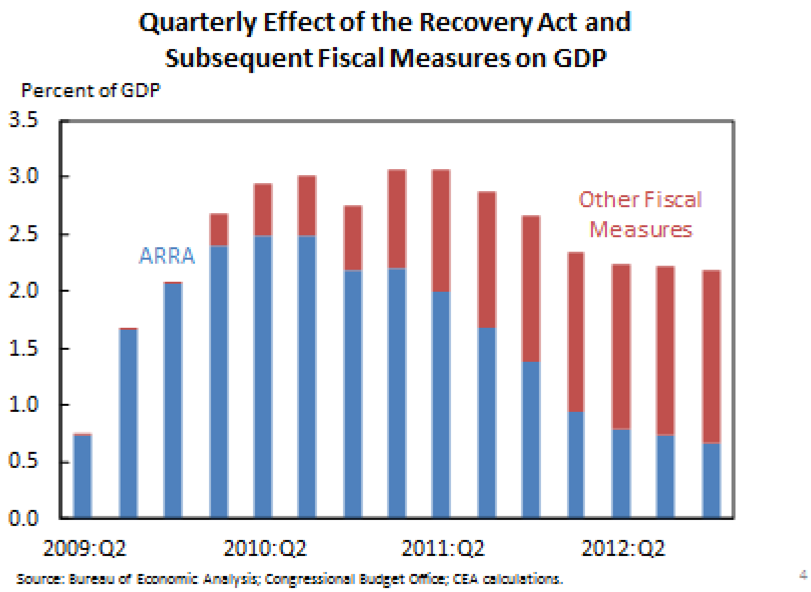
However, the U.S. economy has fared better than most other developed countries in recent years. In fact, among the 12 countries that experienced a systemic financial crisis in 2007 and 2008, the United States is one of just two in which output per working age population has returned to pre-crisis levels (Figure 3). The fact that the United States has been one of the best performing economies in the wake of the crisis supports the view that the full set of policy interventions in the United States made a major difference in averting a substantially worse outcome.

Figure 3: The U.S. is Just One of Two Countries that Experienced a Systemic Financial Crisis But Has Seen Output Per Working Age Population Recover



In particular, a recent report by the Council of Economic Advisers documented that the fiscal support for the economy was not just limited to the Recovery Act, but also included over twelve other subsequent fiscal-jobs measures that cumulatively added 9.5 percent to GDP (Figure 4) and 9 million job-years. And this represents just a subset of the broader policy response that also included the financial rescue, the auto rescue, the efforts on housing—and the independent actions of the Federal Reserve.

Figure 4: The Recovery Act and Subsequent Fiscal Legislation Cumulatively Added 9.5 Percent to GDP From 2009 to 2012



Economic Opportunities

The U.S. economy has made substantial gains over the last five years, and while many challenges remain, including recent weather-related disruptions and some turbulence in emerging markets, there are a number of reasons to be optimistic about the economy's prospects. Cyclical developments like diminished fiscal headwinds and an improvement in household finances are likely to contribute to a strengthening of the recovery in the near-term. At the same time, emerging structural trends like the decline in the rate of health care cost growth, the surge in domestic energy production, and continued technological progress will support growth on a sustained basis into the future.

Cyclical Factors

The most predictable reason for optimism about the U.S. economy in 2014 is the waning drag from fiscal policy and reduced fiscal uncertainty. In December, a bipartisan budget agreement averted a second round of discretionary sequester cuts that were scheduled to go into effect in January and also relieved a portion of the cuts that had already taken place during the preceding year. While Congress could do substantially more to support job growth and economic opportunity, the economy is unlikely to face anything like the fiscal consolidation seen at the Federal level in 2013, with deficit reduction continuing at a much more gradual pace going forward. As fiscal headwinds ease at the Federal level, State and local governments are also showing encouraging signs. After shedding more than 700,000 jobs from 2009 to 2012, State and local governments added 43,000 jobs in 2013.

A second favorable factor in the short-term cyclical outlook is improved household finances. American households saw trillions of dollars in wealth wiped out as a result of the recession, but recent data indicate that a large degree of progress has been made in the recovery. As of the third quarter of 2013, real per-capita household wealth had recouped over 80 percent of the large decline from its peak, reflecting gains in housing and stock prices, as well as the progress households have made in deleveraging. Moreover, the household debt service ratio—the estimated required payments on mortgage and consumer debt as a share of disposable income—was 9.9 percent in the third quarter of 2013, the lowest since the data began in 1980, and down from 13 percent in 2007. Further improvements in household finances and expanded access to credit will contribute to strengthening in consumer spending. Looking over the course of the recovery, real personal consumption expenditures have grown just 2.2 percent at an annual rate, compared with the 2.9 percent pace during the 2000s expansion period, a fact that partly reflects the lingering after-effects of the financial crisis. A noticeable pickup in consumer spending—which comprises more than two-thirds of the U.S. economy—would represent an important step toward turning the page on the crisis era.

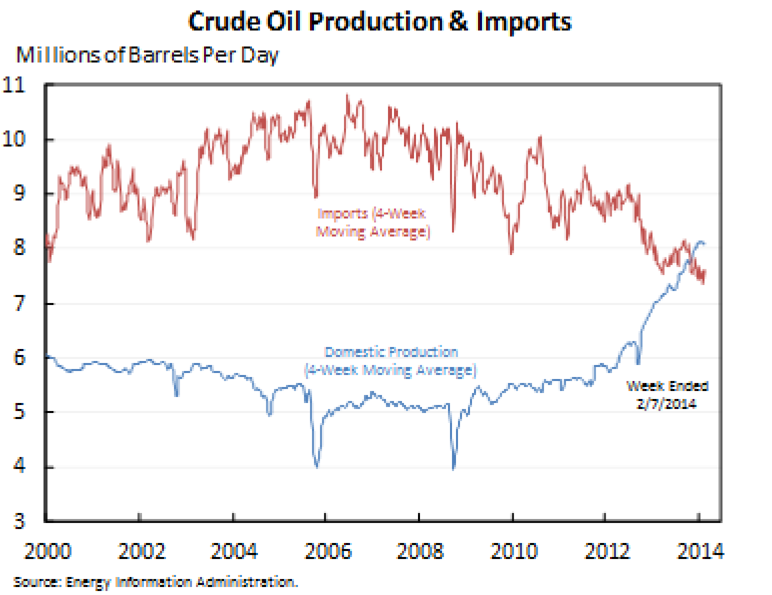
While the aggregate statistics on household wealth paint a picture of improvement, too many families have not shared in the gains. For instance, middle-income households have on average a larger fraction of wealth in their homes relative to equities, and house prices—despite recent improvements—have not recovered as sharply as equities, which represent a larger fraction of the wealth held by upper-income households.

Structural Factors

Along with these positive near-term developments, I want to highlight three longer-term, structural trends that have emerged recently and will support growth on a sustained basis into the future.

The first major trend is the dramatic increase in domestic energy production combined with a shift in the use of energy that represents an important opportunity not just for the economy, but also for America's security and climate. Current projections indicate that the United States became the world's largest producer of oil and gas in 2013, exceeding both Russia and Saudi Arabia. As noted earlier, domestic production of crude oil rose above imports in October for the first time since 1995 (Figure 5), and further increases in domestic production and reduced oil imports are expected in the coming years. Moreover, natural gas production continued to rise in 2013 from the 2012 record-high and is up more than 20 percent over the past five years.

Figure 5: Domestic Oil Production Has Exceeded Imports For the First Time Since 1995



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But the progress is not limited to oil and gas—consistent with the President's "all of the above" energy strategy, great strides have also been made in renewables and energy efficiency. Wind and solar power generation have each more than doubled since the President took office, while oil consumption has fallen over this time, as stronger fuel economy standards and investments in cutting-edge technologies have led to the most fuel-efficient light vehicle fleet ever. This broad-based energy boom supports jobs directly in production and distribution, and also indirectly, by making the United States more attractive as a location for multi-national firms in energy-intensive industries like manufacturing.

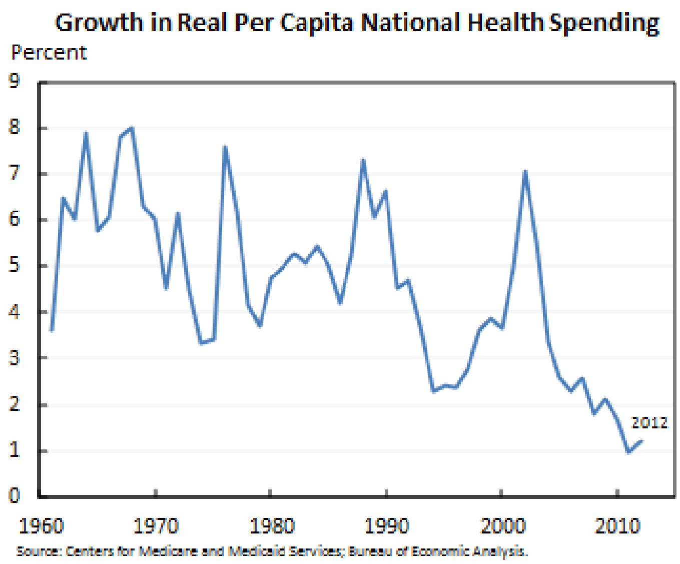
The President recently announced new steps to further capitalize on these exciting developments in the energy sector and reduce our dependence on foreign energy sources while creating new jobs. In the 2014 State of the Union address, the President announced his intention to forge ahead with new executive actions that will improve the fuel efficiency of the nation's trucking fleet and help states and localities attract investment in new factories powered by natural gas.

Although many of the recent trends in the energy sector are positive, looking ahead over the coming decades, climate change continues to pose considerable threats to America's environment, economy, and national security. The combined effects of shifting electricity production from coal to cleaner-burning natural gas, large increases in wind and solar power generation, and ongoing progress in energy efficiency have made a large contribution to reducing national energy-related carbon dioxide emissions by more than 10 percent since 2005. In his Climate Action Plan, the President set out the concrete steps that the Administration is taking to address the costs of climate change through new actions to reduce greenhouse gas emissions and prepare for the future climate changes that are an inevitable consequence of past emissions. The President has also recently directed his Administration to continue working with states, utilities, and other stakeholders to set new standards on carbon pollution from power plants.

The second structural trend is the slowdown in the growth of health care costs. I believe that this trend has been less widely appreciated, possibly in part because of a desire to avoid controversial debates over the Affordable Care Act (ACA) and also because some had believed that it was primarily a cyclical phenomenon that would reverse itself when the economy recovered.

The changes in health care cost growth have been striking: The growth rate of real per-capita health care expenditures from 2010 to 2012 was the lowest since the Center for Medicare and Medicaid Services data began in the 1960s (Figure 6), and preliminary data and projections indicate that slow growth continued into 2013.

Figure 6: Recent Years of Health Care Cost Growth Are Lowest On Record



As detailed in a report released last year by the Council of Economic Advisers, this historic slowdown in health care cost growth does not appear to be merely an after-effect of the recession for three reasons. First, the slowdown has persisted even as the economic recovery has unfolded. Second, we have seen a larger slowdown in Medicare than in private health insurance, which is notable because as the Congressional Budget Office (CBO) and others have stressed, Medicare is not very cyclical. Finally, the slowdown has manifested itself not just in quantities but also in prices, as the gap between health care price inflation and overall inflation has narrowed substantially, a development that should not be sensitive to cyclical fluctuations.

It is increasingly clear that the slowdown in the growth of health costs is a structural phenomenon. The slowdown started before the passage of the Affordable Care Act and is caused by a range of factors, including longer-term trends in cost sharing and several blockbuster drugs coming off patent. But there is no question that some already-implemented features of the Affordable Care Act, including reductions in overpayments to Medicare providers and private insurers as well as payment reforms that incentivize better patient outcomes, are contributing to this trend. In particular, CBO estimated that savings of $17 billion this year which constitutes about 0.6 percent of national health expenditures in 2013. Spread out over the three years from 2010 to 2013, this implies that the ACA alone account for a 0.2 percentage point reduction in the growth of national health expenditures over this period, making a meaningful contribution to explaining the slow growth in health spending observed over this period. Moreover, plausible spillovers to the private-sector, which tend to mirror changes in Medicare, bring the total contribution to the slowdown to 0.5 percentage point annually.

Primarily as a consequence of slower health care cost growth, the Congressional Budget Office has marked down its forecast of spending on Medicare and Medicaid in the year 2020 by about 13 percent relative to the projection it issued in August 2010. Employers and families are also likely to see significant benefits as health care places less pressure on employers' compensation costs, and the resulting savings are passed on to workers in the form of higher wages.

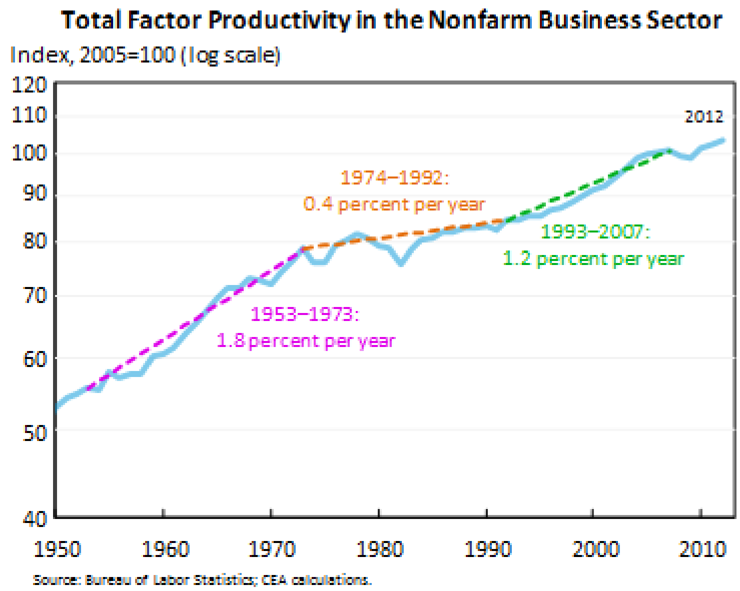
The third emerging trend that presents a major opportunity for long-term growth is the rapid advance in telecommunications technology, particularly in fast and widely available wired and wireless broadband networks, and in their capacity to allow mobile devices to take advantage of cloud computing. From 2009 to 2012, annual investment in U.S. wireless networks grew more than 40 percent from $21 billion to $30 billion, and the United States now leads the world in the availability of advanced 4G wireless broadband Internet services. This infrastructure is at the center of a vibrant ecosystem that includes smartphone design, mobile app development, and the deployment of these technologies in sectors like business, health care, education, public safety, entertainment, and more. All told, the expansion of advanced telecommunications technology—along with the slowdown in health care cost growth and the rise in domestic energy production—are major reasons to be upbeat about the U.S. economy's growth prospects in the coming years.

The Long-Run Growth Challenge

Even with all of these opportunities, the United States still faces a several decades long growth challenge. To put this in context it is helpful to consider the history of total factor productivity growth over the past 60 years. I focus on total factor productivity growth, which reflects technological change as well as the scale of markets and organization of production processes, because it has historically been the most important component of overall labor productivity growth. Specifically, total factor productivity accounts for about half the cumulative increase in labor productivity since the end of World War II.

Over the past 60 years, the growth of total factor productivity has varied widely, but the longer-term trends can be summarized in three episodes (Figure 7). First, from the 1950s through the early 1970s, total factor productivity grew at a relatively rapid 1.8 percent annual rate, fueled in part by public investments like the interstate highway system and the commercialization of innovations from World War II like the jet engine and synthetic rubber. Then, from the mid-1970s to the early 1990s, the rate of total factor productivity growth slowed substantially, to just 0.4 percent a year. The causes of this slowdown have been the subject of extensive academic debate, with much evidence pointing to the disruptive effect of higher and volatile oil prices. Finally, from the mid-1990s through the business-cycle peak in 2007, total factor productivity growth picked up to a 1.2 percent a year rate, in part reflecting vast improvements in computer technology and software during this time.

Figure 7: Recent Decades of TFP Growth Have Been Faster Than 70s-Early 90s but Slower Than 50s-60s



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While the growth rate of total factor productivity is always critical to an economy's long-run potential, the projected slowdown in the growth of America's workforce due to the aging of the population places even greater emphasis on productivity going forward. During the aforementioned 1974 to 1992 period marked by slower total factor productivity growth, the working-age population continued to expand at a solid rate of more than 1 percent a year, helping to counteract the effects of slower productivity growth. However, the Census Bureau projects that over the 20 years from 2012 to 2032, the working-age population will grow only 0.3 percent per year, largely a consequence of the aging of the baby boomers into retirement. Thus, looking ahead, productivity-enhancing investments are likely to be as critical as ever.

The Agenda to Strengthen Economic Growth

As I discussed earlier, the economy took a major hit in the Great Recession but continues to heal. At 6.6 percent, the unemployment rate is lower than what many would have predicted as recently as six months or a year ago, but it is still unacceptably high. That is why the President remains focused on steps to speed the economy's recovery in the near-term, including extending emergency unemployment insurance for workers still looking for jobs. In fact, many of the policies he is proposing would both help to speed the recovery and increase long-term growth.

Let me list some of the significant elements of this agenda:

First, the President's upcoming budget proposal will include a fully paid-for Opportunity, Growth and Security initiative. This proposal is evenly split between defense and non-defense priorities, and makes substantial investment in a number of areas, including basic research, early-childhood education, job training, and placed-based policies to help struggling communities. The initiative would be financed by a balanced package of tax loophole closers and spending reforms.

The President continues to look for ways to make much-needed investments in our nation's infrastructure. And in this area, the President is not waiting for Congress to act. In 2011, he set out a new directive to add more transparency and accountability to the infrastructure permitting process, and in the weeks and months ahead the President will look to build on that progress and make sure projects are getting started as quickly as possible.

At the same time, to the extent that we can get Congress to act on an infrastructure package, we will continue to push to finance that package through the transition to a reformed business tax system—a step that would also benefit the economy in both the short and long run. Business tax reform would cut the top rate to 28 percent, broaden the base, and reform the business tax code. In the process it would expand the economy's potential by reducing the distortions in the current system that skew investment decisions. By developing a system that is more neutral, corporate decision makers can act for business reasons, not tax reasons, which would create an environment in which capital will flow to the most efficient purposes.

In addition to physical capital, it is also essential that we invest in human capital through education and training. Already, the President has given states new incentives to improve their K-12 curricula and taken steps to make college more affordable. To build on this progress, the President has repeated his call for ensuring that every American child attends high-quality pre-school. This proposal is firmly grounded in evidence, with decades of research showing that investments in early-childhood development are among the best investments we as a society can make. And as the President highlighted in his State of the Union address, you will also see important new announcements in the coming months regarding reforms to job training programs and expanded access to apprenticeships.

Among the most important policy proposals to enhance the economy's productivity and long-run output is immigration reform. At a basic level, immigration reform would help counteract the slower growth of the labor force by eliminating existing backlogs for employment-based green cards, and by making it easier for foreign-born individuals earning advanced degrees in the United States to stay here after they graduate.

But there is also strong reason to believe that these immigrants will not simply expand the labor force, but engage in innovative or entrepreneurial activity that further elevates the economy's potential. Research has found that immigrants patent at twice the rate of U.S.-born citizens, and patent at an above-average rate even after controlling for their over-representation in technical occupations. Immigration also has spillover effects on native inventors, with research finding that variation in patent activity across states is tied to changes in states' immigrant populations. CBO affirmed this view when it evaluated the Senate-passed bill, finding that total factor productivity would be a full percentage point higher in 2033 under the legislation. And these innovations can translate into significant economic outcomes—fully 40 percent of Fortune 500 companies were started by a first- or second-generation American.

Immigration reform would help attract inventors and entrepreneurs from overseas to the United States, but the President is also focused on sending more U.S.-made products in the other direction, by completing new free trade agreements with Asia and Europe. The Trans-Pacific Partnership, or TPP, has the potential to be the most significant trade negotiation in a generation, because it includes twelve countries that are home to a combined 793 million consumers and account for nearly 40 percent of global GDP. The Transatlantic Trade and Investment Partnership, or T-TIP, also offers major potential, since it would allow us to build on the more than $400 billion a year in goods and services that our economy exports to the European Union.

To help make these new trade agreements a reality, the President has called on Congress to enact Trade Promotion Authority, a practice that extends back thirty years and allows Congress to set out negotiating objectives while ensuring that final agreements will receive an up-or-down vote.

Finally, all of these policies are part of an overall fiscally responsible framework. The short-run deficit has come down sharply and the debt is on a downward path as a share of GDP over the next several years. Moreover, projections of the long-term deficit by the Congressional Budget Office and the Administration have also been reduced. But it is still the case that after four or five years the debt starts to rise as a share of the economy, driven in part by the combination of an aging society and the continued growth of health costs, which is why additional measures for medium- and long-term deficit reduction are warranted. The President takes a balanced approach, making the investments I have discussed while curbing tax benefits for high-income households and continuing to reduce wasteful, unnecessary and inefficient spending to put the debt on a downward path as a share of the economy.

Ensuring that the Benefits of Growth Are Shared

Finally, the ultimate test of economic performance is not the overall growth rate but ensuring that the benefits of that growth are broadly shared. That process has not been automatic in recent decades as inequality has increased, the growth of median household income has slowed, and many lower-income households have seen their real incomes fall. Of course, stronger growth does help raise incomes and reduce poverty and thus should be at the center of the economic agenda. But conversely, working to ensure that growth is shared can often have benefits in terms of topline economic growth as well.

In the near term, the most direct step is to raise the minimum wage, which, after adjusting for inflation, has declined by more than one-third from its peak in the 1960s and is now worth less than it was when President Ronald Reagan first took office in 1981. Along with a minimum wage increase, the President has also called for other measures that would help those striving to join the middle class, including an expansion of the Earned Income Tax Credit for workers without children. In addition to these immediate steps, the President has set out a range of ideas to invest in education and equip workers with the skills they will need to compete in the global economy for years to come.

Finally, many of the steps I described as contributing to growth—including creating jobs through infrastructure and investing in education and training, are also a key part of the strategy of ensuring that this growth is widely shared.

Conclusion

The challenges we face are substantial, but the President believes that it is well within our capacity as a Nation to address these issues and to move toward shared and sustainable growth. The President has set out an ambitious agenda to support the recovery in the near term, while building on emerging strengths to expand the economy's potential over the long term. In this context, the President also remains focused on restoring greater measures of fairness and opportunity to our economy, to strengthen the middle class and give a boost to those striving to join it. This agenda includes measures to create new well-paying jobs, continue to reduce dependence on foreign energy sources, equip workers with skills to compete in the global economy, support those hardest hit by economic change, and provide families with a greater sense of financial security.